Bank of England PRA

Pillar 2A Lending Adjustments

Walk-through on policy and calculation approach

Prudential Policy Directorate
13 October 2025

Agenda: Walk-through on Pillar 2A lending adjustments policy

1. Recap of the policy
2. ΔRWA component
3. Capital adjustment factor (CAF) component
4. Additional info on policy implementation
5. Q&A

1. Recap of the Pillar 2A lending adjustments policy

1. Overview on Pillar 2A lending adjustments policy

This policy forms part of the PRA's Basel 3.1 package

- In May 2025, the PRA published **PS7/25** setting out details of this policy following the initial announcement in PS9/24
- The PRA committed to ensure the removal of the SME and infrastructure support factors under Pillar 1 **do not cause an increase in overall capital requirements (ie total capital) for SME and infrastructure exposures**.
- This policy will ensure overall capital requirements are at the level they would have been had the support factors been retained (under the PRA's implementation of the Basel 3.1 standards)

Approach to calculating the Pillar 2A lending adjustments

2.6 The Pillar 2A lending adjustments will be firm-specific and calibrated to hold a firm's overall capital requirements[8] for SME and infrastructure lending constant compared to the situation in which the support factors had remained in Pillar 1 under the PRA's implementation of the Basel 3.1 standards. The calculation is as follows:

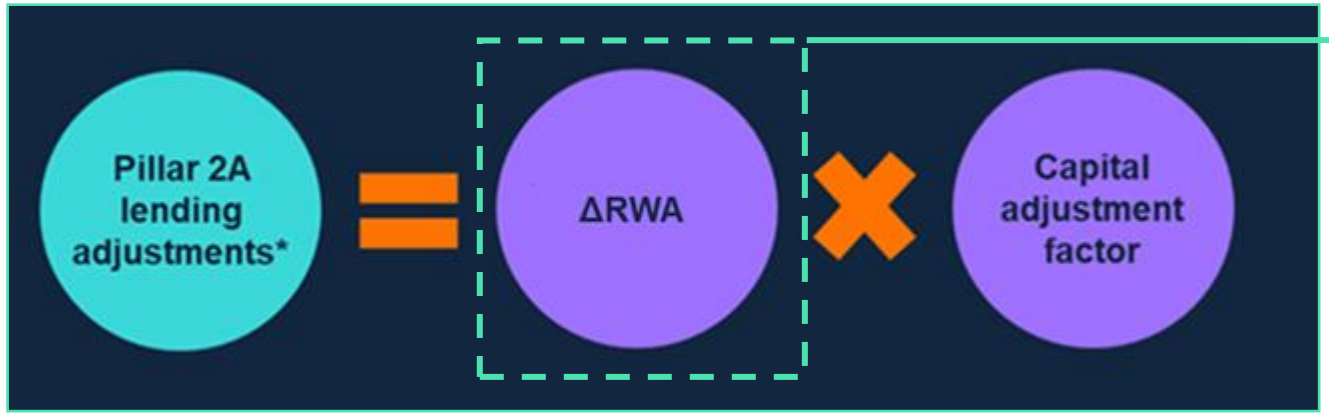
8. As measured in total capital (ie tier 1 capital and tier 2 capital).

PS7/25 – Update to PS9/24 on the SME and infrastructure lending adjustments

This policy improves the outcomes for all firms relative to the PRA's original proposal in CP16/22 – to remove the support factors without any offsets

2. ΔRWA component

1. ΔRWA – impact to RWAs from removing the support factors



ΔRWA will generally be calculated as the difference between:

1. Basel 3.1 RWAs; and
2. Basel 3.1 RWAs with relevant support factor(s) applied.

- We are not comparing Basel 3.1 risk weights (RWs) against the CRR RWs **with** the support factors. This is to preserve the improved risk sensitivity under Basel 3.1 across SME/infrastructure lending types.
- This calculation will be adjusted in limited cases to prevent either: (1) double discounts – where Basel 3.1 RWAs already reflect support factor outcomes (see example on next slide - EU has adopted a similar approach); or (2) further reductions to capital requirements where it would be imprudent to do so due to already significant reductions under the Basel 3.1 standards (see below)

Regulatory retail exposures to SMEs – transactor exposures	The Basel 3.1 RW (45%) for transactor exposures is significantly lower than CRR RW with SME support factor (57%–64%).
Regulatory real estate exposures to SMEs not materially dependent on cash-flow from property	For secured part of exposure, the Basel 3.1 RW (60%) is significantly lower than CRR RW with SME support factor (76.19%–85%).
Substantially stronger project finance exposures (under slotting approach)	The Basel 3.1 RW (50%) for 'substantially stronger' project finance exposures was lowered compared to CRR RW with infrastructure support factor (52.5%).

Worked example for ΔRWA calculation

1 **General methodology – £1m retail SME exposure**

ΔRWA = Basel 3.1 RWAs – Basel 3.1 RWAs with SME support factor

= (£1m x 75% RW) – (£1m x 75% x 0.7619) = **£0.179m***

* *The Pillar 1 RWA is £0.75m. The ΔRWA of £0.179m will be converted into the P2A lending adjustment amount through the capital adjustment factor (CAF)*

2 **Adjusted methodology to avoid double-counting – £1m unrated corporate SME exposure**

ΔRWA = Basel 3.1 RWA for unrated corporate SMEs – Basel 3.1 RWA for general unrated corporates with SME support factor

= (£1m x 85% RW) – (£1m x 100% x 0.7619)

= £0.85m – £0.7619m = **£0.088m**

The P2A lending adjustments essentially replicates the outcome if the support factors were retained without doubling up discounts:

CRR RWAs with SME support factor	Basel 3.1 RWAs less ΔRWA
£1m x 100% RW x 0.7619 = **£0.76m**	£1m x 85% RW – £0.088m = **£0.76m*** * *The Pillar 1 RWA is £0.85m. The ΔRWA of £0.088m will be converted into the P2A lending adjustment amount through the capital adjustment factor (CAF).*

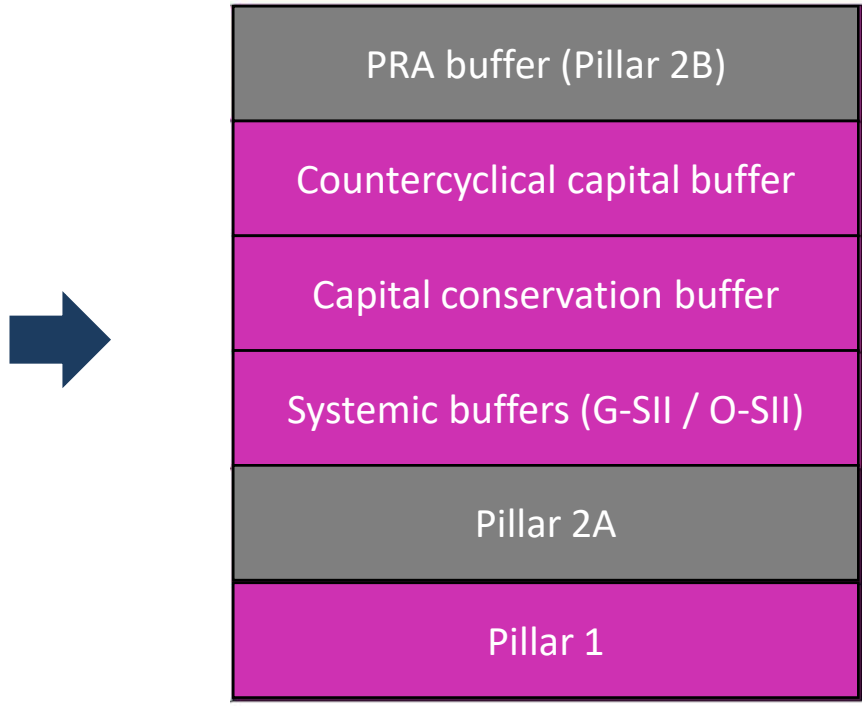
3. Capital adjustment factor (CAF) component

2. Capital adjustment factor (CAF) component

The CAF converts **ΔRWA** into the amount of Pillar 2A adjustments needed to offset the removal of the support factors across the capital stack

- **All capital requirements impacted by the removal of the support factors are reflected in the CAF formula:**
  - **Pillar 1 minimum** total capital ratio
  - **Capital conservation buffer (CCoB)**
  - **Countercyclical capital buffer (CCyB)**
  - **Systemic buffers**

Paragraph 2.19 of PS7/25 – Update to PS9/24 on the SME and infrastructure lending adjustments



Treatment of Pillar 2A capital (in the P2A lending adjustments)

Pillar 2A requirements are not impacted by the removal of the support factors – except for the P2A lending adjustments themselves

- Pillar 2A requirements are typically calculated as nominal amounts before being converted into a percentage of total RWAs when the PRA applies them to firms.

- **For 'Day 1' of Basel 3.1**: as part of the off-cycle review of firm-specific capital requirements the PRA will:

  (1) Adjust Pillar 2A requirements to address any double-counting with Pillar 1

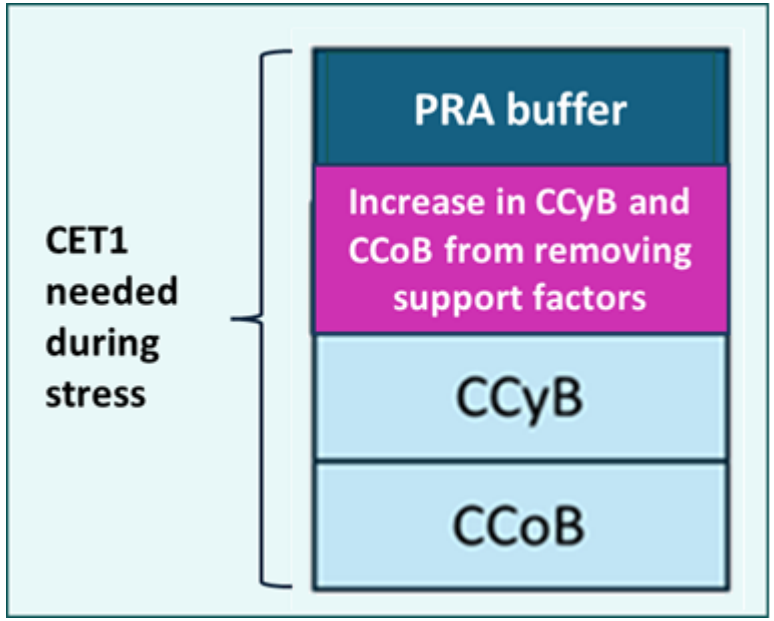
  (2) Then, hold the residual Pillar 2A requirements constant in nominal terms. This is to avoid mechanical shifts to Pillar 2 capital arising from 'Day 1' changes in Pillar 1 RWAs.

  (3) Lastly, deduct the 'Day 1' P2A lending adjustments for eligible firms. Variable P2A will then be re-set as a percentage of projected RWAs under Basel 3.1

- **After 'Day 1':** Pillar 2A requirements will continue to be assessed in nominal amounts as part of the C-SREP process. Variable P2A will continue to be converted into percentages of RWAs when set for firms.

Treatment of PRA buffer (in the P2A lending adjustments)

- The PRA buffer component related to stress testing is determined by the amount of capital a firm needs to withstand a severe but plausible stress.
- **For 'Day 1' of Basel 3.1:** As with Pillar 2A, the PRA's off-cycle review will adjust PRA buffer requirements to address any double-counting with Pillar 1; and hold the residual PRA buffer requirements constant in nominal terms to avoid mechanical shifts arising from 'Day 1' changes in Pillar 1 RWAs.
- **After 'Day 1' of Basel 3.1:**
  - The PRA buffer component related to stress testing will continue to be assessed and set in nominal amounts.
  - The removal of the support factors would not change the PRA's initial assessment of the capital buffers needed to withstand a severe but plausible stress.
  - But since the CCoB and CCyB increase after removal of the SFs, the PRA buffer will reduce by a corresponding amount .



↓ ⇔ ↑

PRA buffer = CET1 needed during stress – (CCoB + CCyB)

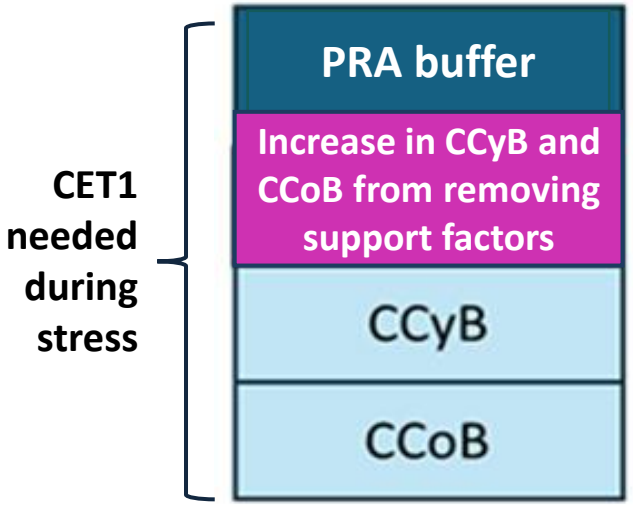
Treatment of PRA buffer (in the P2A lending adjustments)

Therefore, after Day 1, we will reflect the CCoB and CCyB deductions in the CAF calculation

This is to avoid a double impact from:

(1) **PRA buffer** ↓ due to increase in CCoB and relevant CCyB nominal amounts

(2) **Pillar 2A ↓ from the P2A lending adjustments** which already addresses the increase in CCoB and relevant CCyB nominal amounts



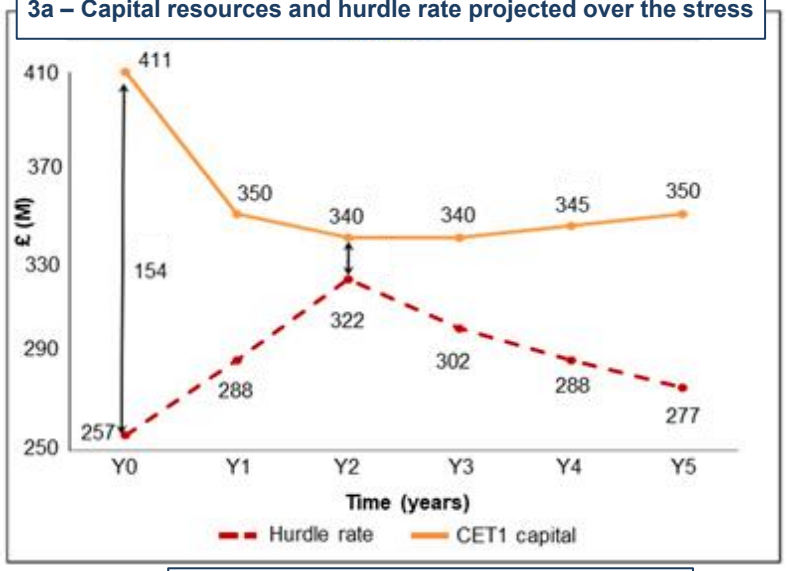
Including the PRA buffer deductions in the CAF ensures this impact is not duplicated – we allow (1) but we remove the CCoB and CCyB from the CAF to eliminate (2)

- This means the PRA buffer reduction will address the impact for the CCoB and relevant CCyB

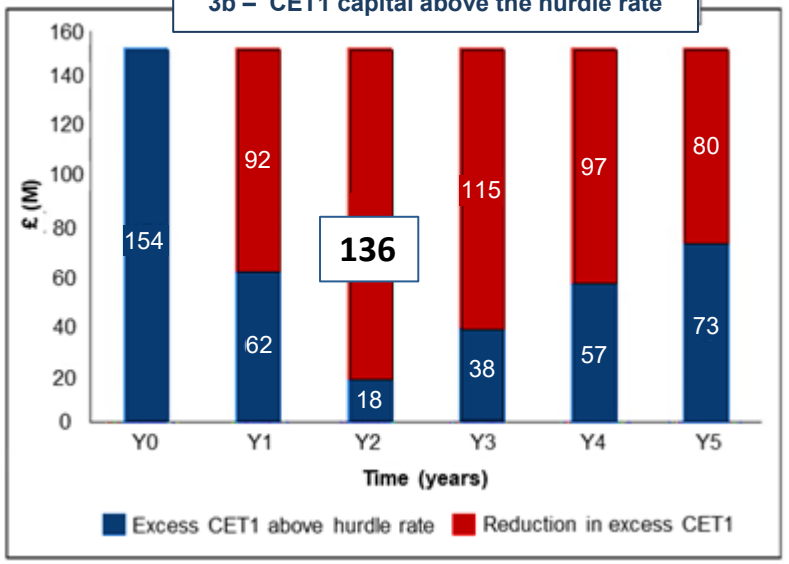
This ensures we do not lower overall capital requirements below the level they would have been had the support factors been retained

Worked example for PRA buffer treatment (all figures from SoP5/15)

3a – Capital resources and hurdle rate projected over the stress



3b – CET1 capital above the hurdle rate



Step 1: Determine the amount of CET1 capital needed during stress

- Stress test projections and a firm's hurdle rate determine the minimum CET1 capital a firm needs to maintain throughout the economic cycle and under a 'severe but plausible' stress
- Figure 3a shows the projected CET1 capital resources and the risk weighted CET1 hurdle rate for a hypothetical firm in a stress scenario
  - For each reporting point, the excess CET1 above the hurdle rate is calculated (**blue bars** in figure 3b).
  - In this example, the total CET1 the firm needs is the **largest reduction in excess CET1 capital** (£136m in figure 3b)

Step 2: Calculate the PRA buffer amount (if needed)

- The PRA buffer is the CET1 amount of capital needed to remain above the hurdle rate during stress that is **not covered by the CCoB and relevant CCyB**.
- Assume Total RWAs = £3,778m | CCoB = £94m (2.5% of RWAs) | CCyB = £19m (0.5% of RWAs).
- PRA buffer = £136m – £94m – £19m = **£23m** = 0.6% of RWAs

Worked example for PRA buffer treatment (figures from SoP5/15)

Step 3: Calculate impact to PRA buffer from removal of support factors

- Total RWAs = £3,778m | CCoB = £94m (2.5% RWAs) | CCyB = £19m (0.5% RWAs) | PRA buffer = **£23m** (0.6% RWAs)
- Assume SME exposures are 20% of RWAs = £756m and purely comprised of retail SME exposures

General methodology – £756m retail SME exposure

ΔRWA = Basel 3.1 RWAs – Basel 3.1 RWAs with SME support factor

= £756m – (£756m x 0.7619)

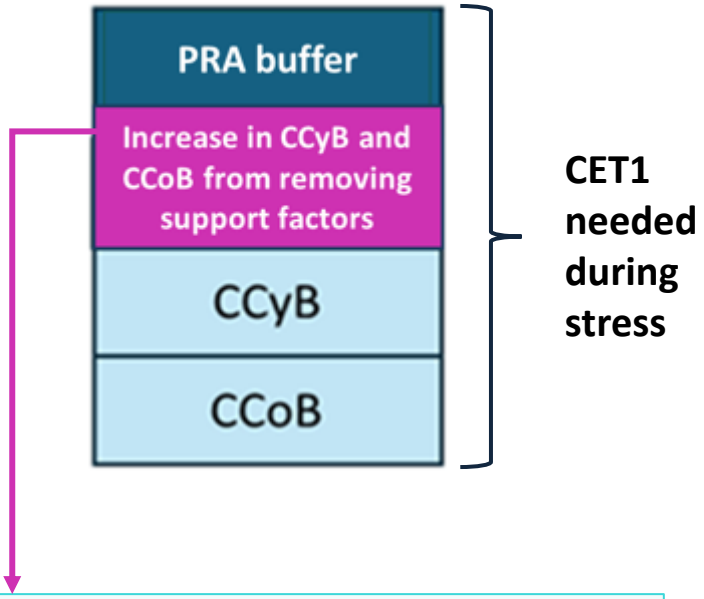
= £180m

Increase in CCoB and CCyB from removing support factors

ΔRWA x (2.5% + 0.5%) = £180m x 3.0% = **£5.4m**

PRA buffer arising from removal of support factors

£23m – £5.4m = £17.6m



PRA buffer reduction covering impact to CCoB and CCyB = £5.4m (fully CET1)

4. Additional info on policy implementation

Additional information: policy implementation

1. **The PRA's analysis of the data suggests all eligible firms have sufficient Pillar 2A capital for the Pillar 2A lending adjustments**

2. **Consistent with its existing approach, the PRA may conduct off-cycle C-SREP assessments in certain exceptional circumstances**

   - For example, in cases where material developments or findings relating to a firm impacts the accuracy or appropriateness of the PRA's previously set capital requirements.